

In the United States Court of Appeals  
for the Ninth Circuit

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MILFORD R. BAUMGARDNER AND PEARL E.  
BAUMGARDNER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

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On Petition for Review of the Decisions of the  
Tax Court of the United States

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BRIEF FOR THE RESPONDENT

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FILED

JUL - 5 1957



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**OPINION BELOW**

The memorandum opinion of the Tax Court (R. 43-57) has not been officially reported.

**JURISDICTION**

This petition for review (R. 60-62) involves federal income taxes for the taxable years 1942, 1944, 1945, 1947, 1948, 1949, 1950 and 1951. On May 11, 1953, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiencies in the amounts of \$16,331.77 and penalties of \$10,-

599.39. (R. 12-16, 21-31.) Within ninety days thereafter and on July 31, 1953, the taxpayers filed petitions with the Tax Court for redetermination of these deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 6, 9, 16.) The decisions of the Tax Court were entered August 30, 1956. (R. 57-59.) The case is brought to this Court by a petition for review filed November 19, 1956. (R. 60-62.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

### QUESTIONS PRESENTED

1. Was the Tax Court upon the record justified in upholding the Commissioner's use of the net worth method in determining taxpayer's income for the years 1942—1951, inclusive, excepting the years 1944 and 1949 in which the deficiencies were determined upon specific omissions from the income returned?

2. Whether the Commissioner fully sustained his burden of proving that a part of the deficiency for each of the taxable years was due to fraud with intent to evade tax?

### STATUTES AND RULE INVOLVED

The pertinent statutes and rule involved are set forth in the Appendix, *infra*.

### STATEMENT

The findings of fact of the Tax Court were based partially upon stipulated facts and exhibits which were incorporated within the findings by reference. (R. 44-51.)

Taxpayer and his wife were residents of Hawthorne, California, for all taxable years in question. For the taxable years 1945 and 1947, taxpayer and his wife filed separate returns in accordance with the community property provisions of the State of California. For all other taxable years prior to 1948 taxpayer filed separate returns in which he claimed his wife as an exemption. For taxable years 1948 and the years thereafter joint returns were filed by taxpayer and his wife. All returns were filed with the Collector of Internal Revenue for the Sixth District of California.<sup>1</sup> (R. 44.)

Taxpayer lived in Oklahoma prior to moving to California. While in Oklahoma he held various jobs with a transfer company, grocery firm and as an operator for a motion picture theater. After his arrival in California he first worked as a restaurant dishwasher and also in a pool hall. Subsequently, he was employed by the Hawthorne Fire Department at a nominal salary. In 1927 he became a member of the Hawthorne police force and remained on the force except for a few short periods until his retirement in 1953. From 1937 until his retirement he was chief of police in Hawthorne, California. Taxpayer married in 1927 and his wife from that day on had no source of income except for the operation of a dress shop from March, 1948, to May, 1950. (R. 44-45.)

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<sup>1</sup> Taxpayer's wife is now a party in this suit only because joint returns were filed for some of the taxable years in question.

For the years 1925 to 1951, inclusive, taxpayer's earnings from the City of Hawthorne show the following (R. 45-46):

1925.....	\$ 45.00
1926.....	1,770.00
1927.....	1,800.00
1928.....	1,840.00
1929.....	1,920.00
1930.....	1,443.36
1931.....	2,068.06
1932.....	1,561.84
1933.....	0
1934.....	1,025.50
1935.....	1,570.00
1936.....	1,609.24
1937.....	1,768.02
1938.....	2,236.69
1939.....	2,220.00
1940.....	2,280.00
1941.....	2,284.20
1942.....	2,400.84
1943.....	2,775.09
1944.....	2,820.07
1945.....	3,066.99
1946.....	3,106.17
1947.....	3,911.83
1948.....	4,213.76
1949.....	4,507.21
1950.....	3,485.80
1951.....	6,061.70

For the years 1930 to 1939, inclusive, taxpayer and his wife filed no federal income tax returns. For 1940 and 1941 he filed returns showing no tax owing for those taxable periods. His wife filed no returns. In fact, prior to 1942 taxpayer and his wife had never paid an income tax. (R. 46.)

In 1937, 1938, 1939 and 1941 taxpayer had made

applications for loans. A study of the loan applications indicates the following (R. 46-47):

In 1937 taxpayer applied for a loan of \$200 with the Bank of America for purposes of paying off another obligation with the same bank having a balance of \$65.98 and also to pay for other expenses. The loan application contained information that at that time taxpayer owed \$250 to the Acme Loan Company, \$105 to the Inglewood Furniture Company and \$70 to the Federal Outfitting Company which were being paid off in monthly installments. Taxpayer listed no other income or source of income other than the police department of Hawthorne, California. The application specifically requested information as to all sorts of income. The bank rejected the loan. (R. 46-47.)

Taxpayer again applied for a loan with the Bank of California in April, 1938. The requested amount was \$200 for the purpose of taking a vacation trip to Oklahoma. Taxpayer stated on the loan application, which he signed, that he owed \$40 to the Marbro Department Store and \$40 to the Inglewood Furniture Company. Again taxpayer listed no other source of income other than the salary from the police department although the loan application specifically requested this information. In January, 1939, taxpayer negotiated a loan with the Bank of America of \$480.30 to refinance a used 1938 Chevrolet. The payments on the loan were to be \$32.02 per month. On the application taxpayer listed his salary of \$185 per month as his only source of income. (R. 47.)

In an application for a loan on property made in

1941 taxpayer and his wife stated their annual income to be \$2,400 per year. This application was signed by taxpayer and his wife. (R. 47.)

The records of the Bank of America where taxpayer carried accounts, upon an analysis prepared by a special agent, showed little activity with no large balances, deposits or withdrawals during the years 1940 to 1944, inclusive. (R. 47-48.)

The Commissioner determined the tax liability of taxpayer for all taxable years in question by the net worth method with the exception of the taxable years 1944 and 1949 in which the deficiency determination was based upon specific items of unreported income. The net worth statements were disputed by taxpayer in regard to three items. These items were the opening cash balance in each of the years in question, an investment in an establishment known as the Beacon Cafe as of December 31, 1946, and all the taxable years thereafter, and an investment in another establishment known as the Embassy Club as of December 31, 1951. The Commissioner determined that taxpayer had an opening cash on hand balance of \$100 in each of the taxable years in question. The Tax Court determined the taxpayer's opening cash balance as of December 30, 1940, was \$5,000 and remained the same through December 31, 1944. The court below further determined that the cash on hand balance for years ending December 31, 1945, through December 31, 1951, was \$3,000 for each individual year. The Tax Court also determined that the 1946 purchase of a interest in the Beacon Cafe made by taxpayer was for a third party who reimbursed tax-

payer. Accordingly, the court decided that taxpayer had no interest in the Beacon Cafe. The court found that in regard to the third disputed item taxpayer became owner of a 5% limited partnership interest in the Embassy Club, a poker club in Hawthorne, California, which had a capital balance in taxpayer's account of \$673.06 as of December 31, 1951. (R. 48, 50-51.)

Taxpayer kept no records of his real estate transactions, the receipts from the poker club, rental income, interest dividends or "commissions." The last named item was reported on his returns of 1947, 1948 and 1949 in the amounts of \$2,000, \$3,000 and \$6,000, respectively. (R. 48.) Taxpayer received interest income during the taxable years from his savings accounts, trust deeds and notes receivables. Most of the interest was collected by the bank and credited to the taxpayer's account. Taxpayer did not report the interest on his tax returns. (R. 48-49.) The interest received for the years below amounted to (R. 48)—

1944.....	\$ 115.03
1945.....	768.77
1946.....	1,093.39
1947.....	929.74
1948.....	904.09
1949.....	705.11
1950.....	626.18
1951.....	530.53

In 1949 taxpayer received rental income of \$1,550; \$1,250 was paid directly to the bank and credited to taxpayer's account and the remaining <sup>1,300</sup> ~~\$3,000~~ was paid to taxpayer by check. None of this amount was

reported on taxpayer's 1949 tax return. (R. 49.) Taxpayer received dividend income in the years 1943 through 1948, inclusive, and also in 1951. The amounts ranged from \$12.50 to \$50. None of these amounts were reported on taxpayer's tax returns for the respective taxable years. (R. 49.) Taxpayer's distributable share in the poker club known as the Embassy Club, of which he was a limited partner, amounted to \$1,126.81 in 1951. He did not report this amount on his tax return for that year. (R. 49.) In 1944 taxpayer reported a gain on his income tax return of \$430 and \$780, respectively, representing the sale of two pieces of property. The actual gains in regard to the two pieces of property amounted to \$4,527.28 and \$2,136.26, respectively. Also, in 1945 taxpayer reported a gain of \$2,257 on a piece of property sold whereas the actual gain was \$5,359.05. (R. 49.) The Tax Court found that returns for each year in which there was a deficiency were false and fraudulent with intent to evade tax and that a part of the deficiency in each of such years was due to fraud with intent to evade tax. (R. 51.) The decision of the Tax Court pursuant to its prior findings of fact and opinion determined the following deficiencies and penalties regarding taxpayer for the following taxable years (R. 58-59):

Milford R. Baumgardner

Year	Tax Deficiency	Penalties	
		Sec. 293(b)	Sec. 294(d) (2)
1945.....	\$856.96	\$428.48	\$55.98
1947.....	316.16	158.08	19.35

Milford R. Baumgardner and Pearl E. Baumgardner

Year	Tax Deficiency	Penalties		
		Sec.	Sec.	Sec.
		293 (b)	294 (d) (2)	294 (d) (1) (A)
1942-----	\$ 647.54	\$ 323.77	\$ ----	\$ ----
1944-----	886.93	443.47	----	----
1948-----	2,954.28	1,477.14	215.86	323.78
1949-----	326.88	163.44	78.22	----
1950-----	5,426.42	2,713.21	334.68	577.80
1951-----	1,434.62	717.31	104.62	174.36

### SUMMARY OF ARGUMENT

Taxpayer had been police chief of Hawthorne, California. The Commissioner of Internal Revenue determined deficiencies against taxpayer and his wife for all the taxable years of 1942 and 1944 through 1951, inclusive, and further determined that taxpayer and his wife had filed false and fraudulent returns for all the previously mentioned taxable years with an intent to evade tax. The special agent investigating this case had prepared a net worth analysis for determining income for the entire period under review. This analysis became the basis of the deficiency determination with the exception of the taxable years 1944 and 1949 in which the deficiencies were determined on the basis of specific omissions of taxable income. Taxpayer objected to the Commissioner's net worth analysis on three matters, namely, beginning cash on hand for all periods, ownership of an interest in the Beacon Cafe, and ownership of an interest in the Embassy Club. The Tax Court found that taxpayer had larger sums of opening cash on hand for all periods than the Commissioner deter-

mined, that he did not have any interest in the Beacon Cafe, but that he did have an interest in the Embassy Club. Further, the Tax Court found taxpayer's wife did not file false and fraudulent returns with intent to evade tax. These conclusions resulted in a decision that taxpayer's wife was not liable for any deficiencies and that the taxpayer's deficiencies were eliminated completely for one year and reduced for three of the remaining eight years.

Taxpayer contends that he had large hoards of cash on hand at the beginning of the net worth analysis which were hidden under his rug at certain times and later kept in his money belt. He says these sums were accumulated by his profits on investments in municipal bonds of Hawthorne, California. He attempted to corroborate his statements by obtaining the testimony of a former investment dealer he did business with. The investment dealer was unable to corroborate taxpayer's assertions except that he remembered taxpayer having purchased bonds although he did not remember the quantity. Taxpayer's contention of having accumulated large sums of undeposited cash is inconsistent with the amounts reported in his income tax returns prior to the beginning of the net worth period. Further, his transactions in obtaining small loans and the fact that he stated on his loan applications that he had no other source of income other than his salary are contrary to his claim of having huge sums of cash on hand. Even his own testimony contains numerous contradictions. The Commissioner made an extensive detailed investigation into the facts relating to taxpayer's claim. The

results of the examination failed to substantiate taxpayer's story.

Taxpayer's returns in comparison with the determination made by the Commissioner as adjusted by the Tax Court show a consistent pattern of under-reporting income in all the taxable years before this Court. In addition, taxpayer specifically failed to report his interest income in all years before this Court except one, failed to report his dividend income in five years on review, grossly understated his gain on sale of real estate in two years, failed to report his distributable share of a partnership interest in one year, omitted his rental income in one year, and did not report income from private investigations he made while a member of the police force in two years before this Court. In addition to proving fraud every one of these items is a likely source of income which taxpayer omitted to report if not an actual source of unreported income.

## ARGUMENT

### I

**Was the Tax Court Upon the Record Justified In Upholding the Commissioner's Use of the Net Worth Method In Determining Taxpayer's Income For the Years 1942-1951, Inclusive, Excepting the Years 1944 and 1949 In Which the Deficiencies Were Determined Upon Specific Omissions from the Income Returned?**

The Commissioner's determination of a deficiency is presumptively correct. *Helvering v. Nat. Grocery Co.*, 304 U.S. 282; *Helvering v. Taylor*, 293 U.S. 507; *Goe v. Commissioner*, 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Snell Isle, Inc. v.*

*Commissioner*, 90 F. 2d 481 (C.A. 5th), certiorari denied, 302 U.S. 734. The burden of overcoming this presumption is upon the taxpayer. The Tax Court concluded that taxpayer had met this burden only to the extent of establishing larger opening cash on hand balances than the figure determined by the Commissioner and, further, that taxpayer had no interest in one eating establishment the Commissioner had credited him with.

Taxpayer now appeals to this Court asserting that his opening cash balance was larger than the adjusted figure the Tax Court determined in that he had large hoards of undeposited cash on that date. (Br. 12-13.) It is a well accepted principle that the Tax Court's findings will not be disturbed upon review except when clearly erroneous; here, it is submitted, the record amply sustains them. The Tax Court based its conclusion instantly in part upon its appraisal of the credibility of witnesses, including taxpayer, who testified before it. Upon review due regard is given to this opportunity possessed by the trial court. *United States v. Gypsum Co.*, 333 U.S. 364, rehearing denied, 333 U.S. 869; *National Brass Works v. Commissioner*, 205 F.2d 104 (C.A. 9th); *Ferrando v. United States* (C.A. 9th), decided June 7, 1957; *Staudt v. Commissioner*, 216 F. 2d 610 (C.A. 4th); *Hague Estate v. Commissioner*, 132 F. 2d 775 (C.A. 2d), certiorari denied, 318 U.S. 787; Rule 52(a), Federal Rules of Civil Procedure; Section 7482(a) of the Internal Revenue Code of 1954 (Appendix, *infra*) (formerly Section 1141(a) of the 1939 Code).

In the deficiency determination thhe Commissioner credited the taxpayer with an opening cash on hand balance of \$100 as of the beginning of each taxable period. The Tax Court adjusted this determination in favor of the taxpayer by deciding that taxpayer's cash on hand balance was \$5,000 for each of the years ended December 31, 1940, through December 31, 1944, inclusive, and \$3,000 for each of the years ended December 31, 1945, through December 31, 1951. (R. 50.) Taxpayer urges that his cash on hand figures for each of the respective years in question were larger that that attributed to him by the Tax Court. A review of the evidence contained in the record and exhibits introduced in the Tax Court proceedings indicates that the Tax Court was, if anything, very liberal in making its determination as to taxpayer's cash on hand balances for the periods in contention.

Taxpayer's wages from the City of Hawthorne in the period 1925 through 1941, inclusive, show very clearly that they were insufficient to allow any substantial accumulations of savings prior to January 1, 1942, in that his maximum salary was only \$2,284.20 in 1941. (Ex. 15-0.) Taxpayer had stated in applying for small loans in 1937, 1938 and 1939 that he had no other source of income other than his salary from the City of Hawthorne. (Exs. II, JJ and KK.) The tax returns of the taxpayer for prior years further corroborate the fact that he had no large accumulations of cash on hand at the beginning of the taxable period under review. Taxpayer had not paid any tax prior to taxable year 1942

and had not even filed a return prior to the taxable year 1940. In addition, the fact that taxpayer had to borrow small sums in 1937, 1938, 1939 and 1941 is entirely inconsistent with his statement that he had large amounts of accumulated cash on hand.

Nevertheless the taxpayer states that he brought a few thousand dollars to California when he arrived from Oklahoma and that he supplemented this amount with profits made on investments in municipal bonds of the City of Hawthorne. (R. 221-224.) He claims that these alleged sums of money were not banked but instead hidden "under the rug" for some years and then kept on his person by means of a money belt for other years. (R. 261, 276.) However, taxpayer's story is replete with inconsistencies. In regard to the amount of cash on hand at the pertinent opening date of the net worth analysis, taxpayer stated on direct examination that he could not tell how much cash he had, on cross-examination he said it was \$6,000, \$8,000 or \$10,000, and he told the special agent of the Internal Revenue Service that he had \$8,000 to \$10,000 under a rug. (R. 169, 262-263, 282.) Taxpayer later stated that he kept this alleged hoard of money in a money belt on the opening date of the net worth analysis. (R. 261.) The special agent testified that taxpayer's wife stated that she did not think her husband was telling the truth about the cash and the largest amount of cash he had on hand at any one time was \$1,000. (R. 174, 193.) She later disputed making this statement at the trial. (R. 200-201.) In fact, there was even an inconsistency in taxpayer's testimony in the trial

below and in his prior statement in a criminal trial as to what period he purchased the municipal bonds. (R. 268-269.)

On the other hand, the special agent who investigated the facts contained in the case at bar made a thorough examination of the taxpayer's claim of cash on hand as of the opening net worth date in conformity with the Supreme Court's pronouncement in criminal net worth cases. *Holland v. United States*, 348 U.S. 121, 135. He stated that he examined the following and was unable to find any evidence of any large amounts of cash on hand as of January 1, 1942, or of any other assets or liabilities other than those listed in the net worth analysis he prepared (R. 181-182):

1. Bank accounts. (R. 178-179, Ex. NN.)
2. Bank loan records. (R. 179.)
3. Records of income tax returns filed. (R. 180; Ex. 12-L.)
4. Bank escrow files. (R. 180.)
5. Payroll records of the City of Hawthorne. (R. 181.)
6. City of Hawthorne bond records. (R. 181.)
7. Record of tax lien sales. (R. 181.)
8. Grantor-grantee indices for Los Angeles County. (R. 181.)
9. Trust deeds and mortgages thereon. (R. 179, 181.)

The sole evidence offered by taxpayer with the exception of his self-serving statement was the testimony of a witness who had stated that he sold taxpayer some bonds in prior years. The testimony of

this witness proves very little if anything as to the sum of money taxpayer had invested in municipal bonds prior to the opening day of the net worth statement, to say nothing of the amount realized upon their disposition. The witness stated that he had no idea as to the specific amount of bonds purchased by the taxpayer. He said though that he thought that it "may be some place between \$15,000 to \$35,000." He explained that when making reference to this figure he was speaking of the par value of the bonds for at that time the bonds were selling in the range of 10¢ to 14¢ on the dollar. He also stated that he did not know whether these bonds were paid at par or whether they were paid at a discount. (R. 256-257.) All in all it cannot be said that this witness introduced any specific evidence whatsoever relating to the amount of cash that taxpayer had as of the opening net worth date. The Tax Court made its own determination as to the opening cash on hand balances. Weighing of all the evidence concerning the disputed amount and the translating of it into an actual monetary figure is a proper judicial function well-recognized by the courts. *Bodoglau v. Commissioner*, 230 F. 2d 336 (C.A. 7th); *Commissioner v. Thompson*, 222 F. 2d 893 (C.A. 3d); *Cohan v. Commissioner*, 39 F. 2d 540 (C.A. 2d). It can hardly be said that the judge below made an arbitrary determination. Upon weighing the evidence and considering all elements he made his determination as to the proper amount of cash on hand for each respective period. The court stated that it did not believe taxpayer had

hidden hoards of money although it did accept the fact that taxpayer invested in bonds. (R. 53-54.) Its determination was grounded in the evidence and was anything but clearly erroneous or arbitrary.

Taxpayer has failed to introduce any evidence whatsoever with the exception of his own self-serving statement as to the amount of the alleged cash hoards that he claimed he had on the opening net worth date. His testimony is vague, bears numerous inconsistencies, and contains implausible statements. The Tax Court upon judging his demeanor as a witness stated it did not believe the taxpayer's claim that he had large cash hoards hidden under rugs and in money belts. The special agent made an intensive and exhaustive investigation into the many records and sources that could substantiate taxpayer's claim. He found nothing. This case would meet the requirements in a criminal case for the successful negation of a taxpayer's claim of hoards of hidden cash on hand at the opening date of the net worth analysis as stated by the Supreme Court. *Holland v. United States*, *supra*; *Friedberg v. United States*, 348 U.S. 142; *Smith v. United States*, 348 U.S. 147; *United States v. Calderon*, 348 U.S. 160. Certainly the facts of this case are more than sufficient to disclaim taxpayer's contention in the instant civil suit.

In the trial below the taxpayer questioned the net worth analysis as to two items in addition to the opening cash on hand balance. These items were two entertainment establishments included as assets of the taxpayer by the Commissioner. (R. 52.) The

Tax Court found that taxpayer had no interest in one establishment but upheld the Commissioner's determination as to the other. (R. 54-55.) The Commissioner accepts this decision in that the facts contained in the record afford a basis for this conclusion. It can be inferred from taxpayer's brief that he also accepts the Tax Court's decision on this matter. (Br. 17.) However, if this be an erroneous inference on the part of the Commissioner, the record containing a letter from the Embassy Club's certified public accountant to the taxpayer informing the latter of his partnership income from the club, in addition to an amendment to the articles of the partnership bearing taxpayer's signature and filed February 6, 1951, certainly substantiate the fact that taxpayer had an interest in a partnership interest in the Embassy Club. (R. 70, Exs. 4-D, R.)

## II

*Whether* The Commissioner Fully Sustained His Burden of Proving that a Part of the Deficiency for Each of the Taxable Years Was Due To Fraud With Intent To Evade Tax?

The burden of proof of fraud rests upon the Commissioner. Section 7454(a) of the Internal Revenue Code of 1954 (Appendix, *infra*). In proving fraudulent intent the Commissioner has to show only that some part of each deficiency was due to fraud with intent to evade tax. Section 293(b) of the Internal Revenue Code of 1939 (Appendix, *infra*). As in the case of a factual determination as to the amount of the deficiency, it is a well accepted principle that

a Court of Appeals does not disturb the Tax Court's factual findings as to fraud if they are supported by clear and convincing evidence. *Helvering v. Kehoe*, 309 U.S. 277; *Rose v. Commissioner*, 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Goe v. Commissioner*, 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Halle v. Commissioner*, 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; *Greenfeld v. Commissioner*, 165 F. 2d 318 (C.A. 4th). It is respectfully submitted that the Tax Court's finding of fraud in this case is amply supported by clear and convincing evidence and should be sustained. In the deficiency notice issued by the Commissioner it was determined that the taxpayer and his wife had fraudulently understated income in their joint tax returns and separate returns for each of the taxable years named in the deficiency notice. (R. 12, 21-22.) In the proceeding in the Tax Court it was found that the taxpayer did have larger amounts of undeposited cash on hand at the pertinent periods in relation to the net worth analysis and also that he did not have an interest in a restaurant establishment that the Commissioner had included as one of his assets. The Tax Court also found that the wife had not filed fraudulent returns for the years in which she filed separate income tax returns—1945 and 1947. This determination eliminated the taxpayer's deficiency completely for the taxable year 1946 and reduced the deficiencies for three of the remaining eight taxable years. However, with all of these adjustments in favor of the taxpayer the evidence still shows that

taxpayer consistently understated his reported income.

A comparison of the income reported by taxpayer on his tax returns and the income determined by the Commissioner as adjusted by the Tax Court's findings under Tax Court Rule 50 (Appendix, *infra*) computation for the taxable years under review is as follows (R. 14-16, 24-31):<sup>2</sup>

	Income reported	Income determined under Rule 50 of the Tax Court
1942	\$ 2,630.76	\$ 5,821.02
1944	3,505.07	7,179.08
1945	2,372.75	6,037.82
1947	2,955.91	4,679.19
1948	7,721.02	19,952.17
1949	10,436.47	11,865.13
1950	4,996.29	27,062.23
1951	6,132.95	12,071.07

It is obvious that there is a shocking disparity between the income reported by taxpayer in his tax returns and that determined by the Tax Court. A persistent failure to report large amounts of income over an extended period without more is strong evidence of fraudulent intent. *Holland v. United States*, 348 U.S. 121; *Smith v. United States*, 348 U.S. 147; *Lipsitz v. Commissioner*, 220 F. 2d 871 (C.A. 4th); *Halle v. Commissioner*, *supra*; *Rogers v. Commissioner*, 111 F. 2d 987 (C.A. 6th). Where, as

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<sup>2</sup> These figures are based on taxpayer's reported net income for 1942, 1948, 1949 and 1951, and on his reported adjusted gross income for years 1944, 1945, 1947 and 1950. The income determined under Rule 50 is based on either net income or adjusted gross income for the same respective years.

here, the pattern of unrecorded and unreported income is accompanied by many of the common badges of fraud, the requisite intent to evade tax is unmistakably clear. See *Goe v. Commissioner*, *supra*; *Lipsitz v. Commissioner*, *supra*; *Heyman v. Commissioner*, 176 F. 2d 389 (C.A. 2d), certiorari denied, 338 U.S. 904; *Cohen v. Commissioner*, 176 F. 2d 394 (C.A. 10th); *Bodoglau v. Commissioner*, 230 F. 2d 336 (C.A. 7th); *Kenney v. Commissioner*, 111 F. 2d 374 (C.A. 5th).

In the instant case the facts indicate that there was more than just the usual inferences of fraud; in this case we have numerous instances where specific items of income were not reported by taxpayer on his income tax return for the taxable years before this Court. The special agent investigating this case questioned taxpayer as to whether he reported all of his income on his tax returns. Taxpayer stated that he did. (R. 159.) However, from a review of the facts it can readily be seen that taxpayer was not being truthful in making this statement.

Taxpayer received interest income in every taxable year on review with the exception of 1942. (Stip. par. 4; Ex. 3-C.) The taxpayer was asked by his own accountant whether he had any other income that was not reported on his tax return. Taxpayer replied that he did not have any other income. (R. 83-85.) But as the income tax returns show for the respective years before this Court, taxpayer never reported his interest income on his returns. (Exs. 17-Q, S, 6-F, 8-H, 9-I, 10-J, 11-K.) Taxpayer attempts to explain this by saying that his interest

expense exceeded his interest income and consequently he saw no need to report the latter as such. (R. 242, 266.) However, this explanation is inconsistent with taxpayer's prior statements and actions. (R. 231, 237.) His returns indicate that they were prepared with detail and expenses and income were purportedly set out as such. Also, in one year interest expense was shown on the return although the interest income earned that year was not. (Ex. 11-K.) Furthermore, taxpayer claims that he had interest expense in one year when he had no liabilities upon which there could be any interest owed. (R. 270.) It must also be noted that taxpayer initially stated on cross-examination that he had reported his interest income. However, he soon contradicted himself when presented with an income tax return and asked to indicate where the interest income was reported. (R. 265-266.) Much of the same can be said for the dividend income earned by taxpayer. In this instance taxpayer earned dividends in the years 1943 through 1948, inclusive, and 1951. (Stip. par. 6.) He was also asked by his accountant when his returns were being prepared whether he had any income other than that he had reported. Here also again he said he had none. (R. 83.) However, the returns for these respective years failed to show any dividend income reported by taxpayer. (Ex. 17-Q, S, 6-F, 8-H, 11-K.)

Taxpayer had a partnership interest in the Embassy Club in 1951. (Stip. par. 7.) He was specifically notified of his share of income earned that year in a letter sent to him by the club's certified

public accountant. (R. 70.) The letter informed him that his distributive share of the income from the club for the year 1951 was an amount in excess of \$1,100. (Exs. R, 13-N, 14-M.) As the 1951 return indicates, taxpayer failed to report this amount although he was certainly put on notice that he had earned the sum in question. (Ex. 11-K.)

As the stipulation between the parties indicates, taxpayer earned rentals in 1949 of \$1,550. (Stip. par. 5.) The 1949 income tax return showed that taxpayer did not report his rental income for that year. (Ex. 9-I.) Clearly taxpayer knew that rental incomes had to be reported since he had reported these sums in prior and subsequent years. (Ex. 16-P, 17-Q, 10-J, 11-K.)

The capital gains realized on sale of real estate by taxpayer in the years 1944 and 1945 present shocking omissions of gains reported. In 1944 taxpayer sold two items of real estate. The amount of gain realized on the sale of these properties was \$8,207.96. (Stip. pars. 9, 10.) The amount reported by taxpayer on his 1944 federal income tax return was \$1,210. (Ex. 17-Q.) Again, in 1945 taxpayer sold property upon which he realized a gain of \$5,359.05. (Stip. par. 11.) However, the gain reported was only \$2,257. (Ex. S.) There is no justification for these actions. Taxpayer attempts to explain it away by saying that he made numerous repairs to his properties that offset any gain he did not report. (R. 232-233.) However, taxpayer's returns indicate that he had taken repairs as a deduction on his returns in the years when they were incurred.

Taxpayer reported certain income in an account title "commissions" in the taxable years 1947, 1948 and 1949. (Exs. 6-F, 8-H and 9-I.) From the record it is rather difficult to determine just what was reported in this account title. (R. 81-82, 166, 236.) Purportedly they were amounts received by taxpayer for performing private investigations while he was a member of the Hawthorne police force. (R. 236, 243, 266.) Taxpayer was very vague in explaining just what "commissions" were to the special agent investigating the facts in the case at bar and also to the Tax Court.<sup>3</sup> And, further, he would not tell who the people were who paid him these "commissions." (R. 157-158, 166, 230.) It is interesting to note that after contradicting himself taxpayer admitted that he also received these type of payments in the taxable years 1950 and 1951. (Ex. RR; R. 266, 273-274.) However, the returns for those respective years fail to show these amounts as being reported. (Ex. 10-J, 11-K.)

In his brief before this Court taxpayer has made the further argument that the Commissioner showed no likely source of income from which it could be stated that taxpayer was receiving unreported taxable income. (Br. 7-15.) Certainly this argument is without substance for the taxable years 1944 and 1949 in that the deficiencies for those years were determined on the basis of specific omissions of items

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<sup>3</sup> In the witness' own words (R. 236) they were: "Any moneys I might receive during the year for interest, for gratuities or anything that might come along, other than my salary."

of income rather than use of the net worth analysis. For those years the unreported income did not come from a "likely source"—it came from an actual source. Likewise, for all of the other years, taxable years in which the Commissioner relied upon the net worth analysis, it can easily be seen from the facts presented that the Commissioner introduced direct evidence of many likely sources of unreported income in regard to the taxpayer. It was shown that taxpayer was a partner in a poker club, the Embassy Club, from which he received income in 1951 which was not reported on his income tax return for that year. (R. 70; Ex. 4-D; Stip. pars. 7-8.) There was evidence that the income tax returns for the years 1944 to 1951, inclusive, show that taxpayer failed to report any interest income earned in those years on the returns for the respective years. (Stip. par. 4; Exs. 3-C, 17-Q, S, 6-F, 8-H, 9-I, 10-J, 11-K.) Also, taxpayer received dividend income during the years 1943 through 1948, inclusive, and 1951, which he failed to report on his income tax returns for those years. (Stip. par. 6; Exs. 17-Q, S, 6-F, 8-H, 11-K.) There were three specific instances in which taxpayer grossly understated the gain on sale of property in the years 1944 and 1955. (Stip. pars. 9, 10, 11; Exs. 17-Q and S.) Finally, taxpayer even indicates a likely source of unreported income himself in his testimony regarding the "commissions" received from private investigations. Regarding this item taxpayer would not divulge any information to the special agent regarding who had paid him the sums he had reported, and there was strong evidence

that by his own admission he received sums in certain years which were not reported. (R. 157-158, 243; Ex. RR, 10-J, 11-K.)<sup>4</sup>

It almost appears frivolous to assert that the Commissioner failed to indicate any likely source of unreported income received by taxpayer. As the record and exhibits indicate taxpayer had numerous likely sources of income from which he could have received the income he failed to report in his income tax return. *Davis v. Commissioner*, 239 F. 2d 187 (C.A. 7th).<sup>5</sup>

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<sup>4</sup> The Tax Court stated that in reaching its conclusion that taxpayer had fraudulently prepared his income tax returns it was not influenced by the testimony of the two witnesses who asserted that they paid protection money which may have reached taxpayer in his position as police chief. (R. 56, 125-127, 136; Ex. 00.)

<sup>5</sup> This brief has not discussed the penalties under Section 294(d)(1)(A) or (d)(2) of the 1939 Code (Appendix, *infra*) in that taxpayer has apparently not questioned them in his brief in this Court or the court below. The Tax Court said (R. 56):

No evidence was adduced with respect to the additions to tax pursuant to Sections 294(d)(1)(A) and 294(d)(2) and the Commissioner's determination in this respect is sustained.

## CONCLUSION

For the foregoing reasons, we submit that the decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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JULY, 1957.

## APPENDIX

## Internal Revenue Code of 1939:

## SEC. 276. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

\*            \*            \*            \*

(26 U.S.C. 1952 ed., Sec. 276.)

## SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

\*            \*            \*            \*

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d) (2).

(26 U.S.C. 1952 ed., Sec. 293.)

## SEC. 294. ADDITIONS TO THE TAX IN CASE OF NONPAYMENT.

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(d) [As added by Sec. 118(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, and amended by Secs. 6(b) (8) and 13(b) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231, Sec. 2 of the Act of January 2, 1951, c. 1195, 64 Stat. 1136, and Sec. 103(b) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Estimated Tax.*—

(1) *Failure to file declaration or pay installment of estimated tax.*—

(A) *Failure to File Declaration.*—

In the case of a failure to make and file a declaration of estimated tax with-

in the time prescribed, unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5 per centum of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 per centum of the unpaid amount thereof for each month (except the first) or fraction thereof during which such amount remains unpaid. In no event shall the aggregate addition to the tax under this subparagraph with respect to any installment due but unpaid, exceed 10 per centum of the unpaid portion of such installment. For the purpose of this subparagraph the amount and due date of each installment shall be the same as if a declaration had been filed within the time prescribed showing an estimated tax equal to the correct tax reduced by the credits under sections 32 and 35.

\* \* \* \*

(2) *Substantial underestimate of estimated tax.*—If 80 per centum of the tax (determined without regard to the credits under sections 32 and 35, in the case of individuals other than farmers exercising an election under section 60(a), or 66  $\frac{2}{3}$  per centum of such tax so determined in the case of such farmers, exceeds the estimated tax (increased by such credits), there shall be added to the tax an amount equal to such excess, or equal to 6 per centum of the amount by which such tax so determined exceeds the estimated tax so increased, whichever is the lesser. This paragraph shall not apply to the taxable year in which falls the death of the taxpayer, nor, under

regulations prescribed by the Commissioner with the approval of the Secretary, shall it apply to the taxable year in which the taxpayer makes a timely payment of estimated tax within or before each quarter (excluding, in case the taxable year begins in 1943, any quarter beginning prior to July 1, 1943) of such year (or in the case of farmers exercising an election under sections 60 (a), within the last quarter) in an amount at least as great as though computed (under such regulations) on the basis of the taxpayer's status with respect to the personal exemption and credit for dependents on the date of the filing of the declaration for such taxable year (or in the case of any such farmer, or in case the fifteenth day of the third month of the taxable year occurs after July 1, on July 1 of the taxable year) but otherwise on the basis of the facts shown on his return for the preceding taxable year. In the case of taxable years beginning prior to October 1, 1950, and ending after September 30, 1950, the additions to tax prescribed by this subsection shall not be applicable if the taxpayer failed to meet the 80 per centum and 66  $\frac{2}{3}$  per centum requirements of this paragraph by reason of the increase in normal tax and surtax on individuals imposed by section 101 of the Revenue Act of 1950. In the case of taxable years beginning prior to November 1, 1951, and ending after October 31, 1951, the additions to tax prescribed by this subsection shall not be applicable if the taxpayer failed to meet the requirements of this paragraph by reason of the increase in rates of tax on individuals imposed by the Revenue Act of 1951.  
(26 U.S.C. 1952 ed., Sec. 294.)

## Internal Revenue Code of 1954:

## SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud*.—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

\* \* \* \*

(26 U.S.C. 1952 ed., Supp. II, Sec. 7454.)

## SEC. 7482. COURTS OF REVIEW.

(a) *Jurisdiction*.—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

\* \* \* \*

(26 U.S.C. 1952 ed., Supp. II, Sec. 7482.)

Rules of Practice Before the Tax Court of the United States (Rev. to August 15, 1955):

## RULE 50. COMPUTATIONS BY PARTIES FOR ENTRY OF DECISION.

(a) *Agreed computations*.—Where the Court has promulgated or entered its opinion determining the issues in a proceeding, it may withhold entry of its decision for the purpose of permitting the parties to submit computations pursuant to the Court's determination of the issues, showing the correct amount of the deficiency or overpayment to be entered as the decision. If the parties are in agreement as to the amount

of the deficiency or overpayment to be entered as the decision pursuant to the report of the Court, they or either of them shall file promptly with the Court an original and two copies of a computation showing the amount of the deficiency or overpayment and that there is no disagreement that the figures shown are in accordance with the report of the Court. The Court will then enter its decision.

\* \* \* \*